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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935

No. 346

MATSON NAVIGATION COMPANY (a corporation), THE OCEANIC STEAMSHIP COMPANY (a corporation), and MATSON TERMINALS, INC. (a corporation),

Appellants,

vs.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA, JOHN C. CORBETT, FRED E. STEWART, R. E. COLLINS, H. G. CATTELL and RAY L. RILEY, the members of said State Board of Equalization, and CHARLES J. McCOLGAN, Franchise Tax Commissioner of the State of California,

Appellees.

BRIEF OF APPELLEES

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BRIEF OF APPELLEES

INTRODUCTION

The appellant corporations, Matson Navigation Company, The Oceanic Steamship Co., and Matson Terminals, Inc., question the validity of a proposed

assessment of additional tax under the California Bank and Corporation Franchise Tax Act (Cal. Stats. 1929, ch. 13, as amended) in the amount of $19,637.71 for the year 1931, based on their consolidated net income for the year 1930.

The Bank and Corporation Franchise Tax Act, hereinafter referred to as the Act, was enacted March 1, 1929, pursuant to section 16 of Article XIII of the California Constitution adopted in November, 1928. Prior to the adoption of section 16, franchises of corporations (with the exception of certain public utility and insurance companies which were taxed on their gross receipts and gross premiums respectively) were taxed as property pursuant to section 14(d) of Article XIII of the Constitution. *Miller & Lux* vs. *Richardson,* 182 Cal. 115. Under section 14(d), and the statutes enacted to carry that section into effect, the State Board of Equalization assessed corporate franchises at their actual cash value and to this value the statutory rate of tax was applied. Cal. Pol. Code Sec. 3664(d). The validity of that tax as applied to The Oceanic Steamship Company, one of the appellants in this case, was sustained by this court in *Schwab* vs. *Richardson,* 263 U. S. 88, notwithstanding the fact that the value of the company's franchise arose in large part from its business in interstate and foreign commerce.

The adoption of section 16 of Article XIII changed the method of taxing financial, mercantile,

manufacturing and business corporations doing business within the limits of the state. Subdivision 2(a) of this section provided that *in lieu of* the tax imposed by section 14(d) these corporations should annually pay to the state for the privilege of exercising their corporate franchises within the state a tax according to or measured by their net income. All other corporations, i.e. corporations not financial, mercantile, manufacturing and business corporations, and corporations not doing business remained fully subject to the provisions of section 14(d).

Consistent with subdivision 2(a) of section 16, section 4 of the Bank and Corporation Franchise Tax Act enacted in 1929 to carry the constitutional provision into effect provided that "every financial, mercantile, manufacturing and business corporation doing business within the limits of this state, of the classes referred to in subdivision 2(a) of section 16 of article thirteen of the constitution of this state, shall annually pay to the state, for the privilege of exercising its corporate franchises within this state, a tax according to or measured by its net income, to be computed, in the manner hereinafter provided, at the rate of four per centum upon the basis of its net income for the next preceding fiscal or calendar year."

Although section 4 of the Act provided that the tax for any year should be based upon net income for the next preceding fiscal or calendar year and

did not specifically exclude from the measure of the tax income from business done without the state, section 10 of the Act provided that in case the entire business of a corporation was not done within the state the tax should be according to or measured by that portion of the income which was derived from business done within the state, such portion to be determined "by an allocation upon the basis of sales, purchases, expenses of manufacture, pay roll, value and situs of tangible property, or by reference to these or other factors, or by such other method of allocation as is fairly calculated to assign to the state the portion of net income reasonably attributable to the business done within this state and to avoid subjecting the taxpayer to double taxation."

These provisions of section 10 were interpreted by the State Supreme Court when this case was before it as excluding from the measure of the tax income from business done outside the state. *Matson Navigation Company, et al.* vs. *State Board of Equalization, et al.*, 3 Cal. (2d) 1.

In view of the above provisions, it appears that the Act as it read in 1931 imposed upon financial, mercantile, manufacturing and business corporations for the privilege of exercising their corporate franchises within the state a tax according to or measured by their net income, exclusive of income from business done without the state, for the next preceding fiscal or calendar year. Furthermore,

this tax was in lieu of property taxes upon the corporations subject thereto.

The appellant corporations are all domestic corporations organized under the laws of and deriving their corporate powers and franchises from the State of California. All the corporations were actually engaged in purely intrastate business in the state during the year for which the tax in question was imposed. In addition to the privilege of doing business, all the appellant corporations obtained from the state at the time of incorporation the privilege of doing a number of things which might or might not constitute doing business depending on the manner and extent to which done, such as the right to buy, hold and sell all kinds of property including stock of other corporations, to borrow and lend money, to enter into contracts, to guarantee, underwrite or secure notes, bonds and other evidences of indebtedness of persons, firms or corporations, to execute bonds, promissory notes, etc.

During the years 1930 and 1931, the business of Matson Terminals Inc. was conducted entirely within California. Matson Navigation Co. and The Oceanic Steamship Co. in addition to their purely intrastate business engaged in the business of transportation of passengers and goods in interstate and foreign commerce between ports in California and ports in other states and foreign countries. In connection with their transportation business the

companies maintained offices in the state and facilities for the loading and unloading of freight and for the embarking and disembarking of passengers.

In their consolidated return of income for the year 1930 appellants included net income from their purely intrastate business but did not include any portion of their net income from their interstate and foreign commerce. The Franchise Tax Commissioner determined, however, that 22.2 per cent of appellant's net income from their interstate and foreign commerce was reasonably attributable to business done in California and, accordingly, recomputed the tax liability and proposed the additional assessment in question.

Upon appeal to the State Board of Equalization, the board, upon the evidence submitted to it, approved the formula employed by the Commissioner and found that 22.2 per cent of appellants' net income from its interstate and foreign commerce was reasonably attributable to business done in the state. Although an appeal was taken to the California Supreme Court from the board's decision sustaining the assessment the correctness of this finding was not questioned and is, therefore, not in issue here. Before the State Supreme Court, appellants contended that the Act should not be interpreted as requiring the inclusion in the measure of the tax any part of the net income from interstate or foreign commerce and that if it were interpreted to include any such net income, the act violated the United States Constitution. The State Supreme

Court decided against appellants on both contentions.

Since the first contention simply involves an interpretation of the California Act, the decision of the court thereon is not in issue here. Thus, the only question before this court is whether it is within the power of a state under the Constitution of the United States to impose a franchise tax upon a domestic corporation doing intrastate business within its limits for the privilege of exercising its corporate franchises within the state measured by net income which includes net income from interstate and foreign commerce reasonably attributable to business done within the state.

Appellees contend that the imposition of such a tax does not violate the Constitution of the United States.

I

THE NATURE OF THE TAX

Section 16 of Article XIII of the California Constitution by specifically making the tax in lieu of the franchise tax imposed by section 14(d) of that article demonstrates that it contemplated a tax upon the same subject as that of the tax superseded, namely, all corporate privileges.

Section 1 of Article XIII of the Constitution provided and still provides that:

> "All property in the state except as otherwise in this constitution provided, not exempt under the laws of the United States, shall be taxed in

proportion to its value, to be ascertained as provided by law, or as hereinafter provided. The word 'property,' as used in this article and section, is hereby declared to include moneys, credits, bonds, stocks, dues, *franchises*, and all other matters and things, real, personal, and mixed, capable of private ownership; * * *." (Italics added.)

Subdivision 2a of section 16 provided:

"All financial, mercantile, manufacturing and business corporations doing business within the limits of this state, subject to be taxed pursuant to subdivision (d) of section 14 of this article, *in lieu* of the tax thereby provided for, shall annually pay to the state *for the privilege of exercising their corporate franchises within this state* a tax according to or measured by net income." (Italics added.)

Section 14(d) provided:

"All franchises other than those expressly provided for in this section, [franchises of public utility and insurance companies] shall be assessed at their actual cash value, in the manner to be provided by law * * *"

In pursuance of this constitutional provision, the legislature, in California Political Code section 3664d, provided that:

"These franchises shall include the actual exercise of the right to be a corporation and to do business as a corporation under the laws of this state and the actual exercise of the right to do business as a corporation in this state when such right is exercised by a corporation incorporated

under the laws of any other state or country, also the right, authority, privilege, or permission to maintain wharves, ferries, toll roads, and toll bridges, and to construct, maintain or operate in, under, above, upon, through or along any streets, highways, public places, or waters, any mains, pipes, canals, ditches, tanks, conduits or other means for conducting water, oil or other substances."

It is clear, therefore, that the subject of the original tax covered all privileges or rights granted by public authority.

Certain classes of corporations, i.e. those which were not mercantile, manufacturing or business corporations remained subject to this tax after the adoption of section 16, and all corporations which exercised merely the privilege of being, without doing business, remained subject thereto. The other classes of corporations were subjected by section 16 to the new tax *in lieu* of the old if they exercised the privilege of doing business. Thus all corporations receiving any privileges from the state were taxable thereon. The subject, namely, all corporate privileges, remained the same under both taxes. The measure alone varied. Under the original tax corporate franchises were taxed according to the corporate excess. *Miller & Lux* vs. *Richardson,* 182 Cal. 115. Under the new tax they are taxed according to net income. *Pacific Co.* vs. *Johnson,* 284 U. S. 480, 212 Cal. 148. If corporations did not exercise one of their corporate privileges, i.e. the doing of business, they remained subject to the original tax. If

they did exercise that privilege in addition to their other corporate privileges, they became subject to the new tax. The doing of business, therefore, did not become a new subject of taxation; it merely became a condition by which the same subject was taxed according to a new measure.

A. THE TAX BEING IN LIEU OF A PROPERTY TAX IS VALID FOR THAT REASON ALONE

This court has repeatedly upheld taxes on gross receipts from interstate commerce if in lieu of ad valorem taxes.

Maine vs. *Grand Trunk Railway Co.*, 142 U. S. 217, as explained in
Galveston Harrisburg Ry. vs. *Texas*, 210 U. S. 217;
United States Express Co. vs. *Minnesota*, 223 U. S. 335;
Pullman Co. vs. *Richardson*, 261 U. S. 330;
Cudahy Packing Co. vs. *Minn.*, 246 U. S. 450.

The tax imposed by the Act is in lieu of an ad valorem property tax upon the full cash value of appellant's franchises. See Article XIII, section 16, of the California Constitution pursuant to which the Act was passed, and section 14(d) of that article taxing corporate franchises as property. See also *Miller & Lux* vs. *Richardson*, 182 Cal. 115, unequivocally holding that the tax imposed by section 14(d) was a property tax. If in lieu taxes upon *gross* receipts do not burden interstate com-

merce *a fortiori* an in lieu tax measured by *net income* can not burden such commerce.

In *Schwab* vs. *Richardson,* 263 U. S. 88, 188 Cal. 27, it was held that the tax imposed pursuant to section 14(d) upon the value of the franchises of The Oceanic Steamship Company, one of the appellants herein, was valid notwithstanding the value of the franchises was derived from interstate and foreign commerce. In the course of its opinion in the *Schwab* case this court declared:

> "Three contentions are made against the assessment and levy. (1) They deprive the Company of its property without due process of law. (2) They are an attempt to regulate interstate and foreign commerce. (3) They are burdens upon interstate commerce.
>
> "The argument is that they have such effect because they are 'based on the value of property outside of California and on interstate and foreign commerce engaged in, so that the amount of' them 'grows in proportion to the growth of such property and commerce.'
>
> "The basis of the contention is not a new one in this Court. It is not always easy to answer and has involved difference of opinion. Any property of a corporation engaged in interstate commerce may be said to take on value from such commerce and a tax on the property be increased as the commerce increases. The cases, however, have been careful to distinquish when such effect produces illegality and when it does not.

"They have been careful to declare the immunity of interstate commerce from state taxation, but as careful to declare the power of a State to tax values within its borders though they may get enhancement from the exercise of rights outside of those borders. How intimate and direct such rights must be cannot be pronounced in formula. A state may not burden or interfere with interstate commerce or tax property outside of its borders, yet, on the other hand, it has a definite sphere of government which must not be curtailed. Certainly it is not restricted to property taxation, nor to any particular form of excises." 263 U. S. 88, 91–92.

And further on it declared:

"Plaintiff in error resists these cases, yet concedes the power of the State to tax the franchise —a 'right of its own creation' and concedes that neither the constitutional provisions nor the statute under which the tax was levied 'are on their face obnoxious to the commerce or due process clause of the Federal Constitution.' That effect is worked, it is the contention, emphasized by repetition, because the tax is based in whole or in substantial part on the value of the property outside of California, or on interstate or foreign commerce engaged in, so that the amount of it grows in proportion to the growth of such property or commerce.

"The contention and its basis are in antagonism to the cases cited and their authority. A repetition of their reasoning is unnecessary." 263 U. S. 88, 93.

If domestic corporations can be required to pay as a tax a percentage of the value of their corporate franchises, even though the value be derived from interstate or foreign commerce, and if domestic corporations can be required in lieu of such a tax to pay a percentage of their gross receipts from transactions within the state even though derived from interstate and foreign commerce, clearly they can be required in lieu of such a tax to pay a percentage of their net income from transactions within the state even though derived from interstate or foreign commerce.

B. THE SUBJECT OF THE TAX, WHETHER ON THE PRIVILEGE OF EXERCISING CORPORATE FRANCHISES WITHIN THE STATE, THE PRIVILEGE OF DOING INTRASTATE BUSINESS OR THE DOING OF INTRASTATE BUSINESS, IS UNQUESTIONABLY WITHIN THE JURISDICTION OF THE STATE

Both the constitutional provision pursuant to which the Act was passed (Cal. Const. Art. XIII, Sec. 16) and the Act itself (Sec. 4) clearly provided that the tax was imposed upon the corporations subject thereto *"for the privilege of exercising their corporate franchises"* within the state. All of the appellant corporations, being domestic, derived numerous privileges and franchises from the state which they admittedly exercised in the conduct of business and other activities purely intrastate in nature within the state during the year

for which the tax in question was imposed. There can be no doubt of the state's power to exact a tax for the exercise of such privileges and franchises within its limits.

Appellants contend, however, that the tax was upon the actual doing of business and since they were doing business in interstate or foreign commerce, it must have been on such business as well as their purely intrastate business. Even if it be conceded that the tax was upon the doing of business, there is no basis for concluding that the tax was upon the doing of business in interstate or foreign commerce. Appellants' contention would be plausible if they were engaged exclusively in interstate or foreign commerce. All of the appellants, however, were engaged in purely intrastate business during the period in question. Clearly, the state may exact a franchise tax from a domestic corporation doing intrastate business within its limits. If the corporation is doing intrastate business, the fact that it is also doing business in interstate or foreign commerce is immaterial.

Detroit International Bridge Co. vs. *Tax Appeal Board of Michigan,* 287 U. S. 295.

The tax in the *Detroit Bridge* case, as in this case, was upon a domestic corporation "for the privilege of exercising its franchise" and of transacting its business within the state. This court held in that case that since the corporation had the right to do business not within the protection of the commerce

clause it was a matter of indifference whether the corporation was engaged in interstate or foreign commerce. If the doing of business in interstate or foreign commerce is a matter of indifference when the tax is upon the *right to do* business and the corporation has the right to do intrastate business *a fortiori* the doing of business in interstate or foreign commerce is a matter of indifference when the tax is upon the *doing* of business and the corporation actually does intrastate business.

That the legislature did not intend to impose the tax upon the doing of business in interstate or foreign commerce is abundantly clear from the opinion of the California Supreme Court in this case holding that the

> "* * * act was intended to and by its terms does impose on the corporations of the type mentioned, *for the privilege of exercising their corporate franchises within this State,* the tax therein provided, whether such corporation is a foreign or domestic corporation, and whether engaged in interstate or foreign commerce or not, *so long as such corporation is doing some intrastate business as well.* We are likewise of the opinion that the act clearly, without ambiguity, imposes on foreign and domestic corporations of the classes mentioned, when they are engaged in both intrastate and interstate commerce, *for the privilege of engaging in intrastate commerce,* a franchise tax measured by or according to their net income, and that the act provides in such cases that income from

interstate or foreign commerce shall be included in measuring the tax to the extent limited in the act." (Italics added.) (Tr. Rec. p. 66.)

The decision of the California Supreme Court is controlling unless it could be established that in actual operation the Act had the effect of imposing a tax upon interstate or foreign commerce. It may be argued that such an effect results from the fact that net income from interstate and foreign commerce attributable to business done within the state is included in the measure of the tax. This argument confuses the measure with the subject of the tax.

That a corporate franchise tax measured by net income is not a tax upon the net income is no longer open to argument.

Pacific Co. vs. *Johnson,* 285 U. S. 480;
Flint vs. *Stone Tracy Co.,* 220 U. S. 107;
Educational Films Corp. vs. *Ward,* 282 U. S. 379.

If a tax measured by net income, including net income from tax exempt securities is not a tax upon such net income, or upon the securities from which derived, *a fortiori* a tax measured by net income including net income from interstate or foreign commerce is not a tax upon such net income or the business from which derived.

The distinction between subject and measure is particularly clear in the California Act because the tax for one year is measured by net income for the

preceding year. Accordingly, even if the appellants had done no business in interstate or foreign commerce during the year 1931 the tax in question measured by net income for the year 1930, including net income from interstate and foreign commerce attributable to business done in this state would nevertheless have been imposed. Conversely, if appellants had done no business in interstate or foreign commerce during the year 1930, the tax for 1931 would not have been measured in part by net income from interstate or foreign commerce, notwithstanding that appellants in 1931 did business in interstate or foreign commerce in addition to their purely intrastate business. Finally, if appellants had done business only in interstate or foreign commerce during the year 1931, they would not have been subject to the tax measured by net income for the year 1930 even though all of their 1930 net income was derived from intrastate business. It is inescapable, therefore, that the subject of the tax was not the doing of business in interstate or foreign commerce.

Appellants rely upon

Ozark Pipe Line Corp. vs. *Monier,* 266 U. S. 555;

Alpha Portland Cement Company vs. *Massachusetts,* 268 U. S. 203;

Sprout vs. *South Bend,* 277 U. S. 163;

Anglo Chilean Nitrate Sales Corporation vs. *Alabama,* 282 U. S. 212;

Cooney vs. *Mountain State Telephone and Telegraph Co.,* 294 U. S. 384.

All of these cases with the exception of the *Cooney* and *Sprout* cases involved franchise taxes on foreign corporations not engaged in intrastate business. The *Cooney* case invalidated an annual license for each telephone instrument used in the state on the ground that all of the telephone instruments were available and substantially used in interstate commerce. The *Sprout* case involved a license tax on motor busses engaged exclusively in interstate commerce (277 U. S. 163, 171).

It is clear that none of these cases has any relation to a tax on domestic corporations engaged in intrastate business for the privilege of exercising their corporate franchises in the state.

The tax is measured by net income, i.e., the fruits and benefits of the privileges granted by the state, and is accordingly increased or decreased in proportion to that net income. While the state could legitimately have considered the total net income as a measure of the value of the privileges granted and while the direct taxation of such total net income is beyond question, it nevertheless, as an insurance against multiple state taxation, limited the measure to net income attributable to sources within the state.

By section 7 of the Act net income is defined as "gross income" less certain allowed deductions, and section 6 provides that gross income,

> "includes gains, profits and income derived from the business of whatever kind and in whatever form paid; gains, profits or income from dealings

> in real or personal property gains, profits or income received as compensation for services, as interest, rents, commissions, brokerage or other fees, or otherwise received in carrying on such business all interest received from Federal, State, municipal or other bonds, and, except as hereinafter otherwise provided, all dividends received on stocks."

The tax rises or falls in accordance with the net income which in turn registers the value of the corporate privileges. The tax is imposed solely on account of corporate privileges granted by the state and not on account of interstate commerce since one engaged exclusively in interstate commerce would not be subject to the imposition and the person taxed could discontinue the intrastate business without withdrawing from the interstate business.

If it is greater because of the taxpayer's business in interstate commerce, the net income from which can in any event be taxed directly, it is also greater because of income from tax exempt securities which can not be taxed directly, and because of interest, dividends, gains and profits not derived from purely intrastate business. In *Schwab* vs. *Richardson*, 263 U. S. 88, *Underwood Typewriter Co.* vs. *Chamberlain*, 254 U. S. 113, *Bass, Ratcliff & Gretton* vs. *State Tax Commission*, 266 U. S. 271; *Hump Hairpin Co.* vs. *Emerson*, 258 U. S. 290, *Western Cartridge Co.* vs. *Emerson*, 281 U. S. 511, and all of the cases upholding the taxation of net

income from interstate commerce the amount exacted was increased because of interstate business done. There, as here, the effect upon interstate commerce was remote and incidental.

The measure of the tax is not the source of the income but the net income itself, perhaps the fairest measure of a tax on corporate privileges. It is difficult to see how the source could impair the propriety of a measure clearly related to the subject of the tax. The tax no more burdens interstate or foreign commerce than any other source of income mentioned in section 6 and has the added virtue, not present in the cases upon which appellants rely, of being upon an unquestionably proper subject, and, so far as the issues in the present case are involved, measured by elements clearly within the power of the state to tax directly.

There would seem to be no doubt about the exercise of a state's taxing power over its own creatures whenever such taxing power involves not even a remote conflict with federal power. As this court said in *Metcalf* vs. *Mitchell,* 269 U. S. 514:

> "'In a broad sense, the taxing power of either government, even when exercised in a manner admittedly necessary and proper, unavoidably has some effect upon the other. The burden of federal taxation necessarily sets an economic limit to the practical operation of the taxing power of the states, and vice versa. Taxation by either the state or the federal government affects in some measure the cost of operation of the other.

'But neither government may destroy the other nor curtail in any substantial manner the exercise of its power. Hence the limitation upon the taxing power of each, so far as it affects the other, must receive a practical construction which permits both to function with the minimum of interference each with the other; and that limitation can not be so varied or extended as seriously to impair either the taxing power of the government imposing the tax (*South Carolina* v. *United States,* 199 U. S. 437; *Flint* v. *Stone Tracy Co., supra* at page 172) or the appropriate exercise of the function of the government affected by it. *Railroad Co.* v. *Peniston,* 18 Wall. 31.' "

II

THE MEASURE OF THE TAX IS BEYOND QUESTION

The *subject* of the tax being thus unquestionably within the jurisdiction of the state to tax, it remains only to demonstrate that the *measure* is equally proper.

In *Pacific Company* vs. *Johnson,* 285 U. S. 480, this court sustained the validity of the Act now in question, in so far as it levied the tax measured in part by income from tax exempt securities which could not be taxed directly. This case compels the conclusion that net income arising in part from interstate or foreign commerce could likewise be included in the measure of the tax even if it were not subject to taxation directly. But it is

well settled that a state may directly tax net income from interstate and foreign commerce.

United States Glue Company vs. *Oak Creek,* 247 U. S. 321;
Shaffer vs. *Carter,* 252 U. S. 37;
Peck & Co. vs. *Lowe,* 247 U. S. 165;
National Paper & Type Co. vs. *Bowers,* 266 U. S. 373;
Barclay & Co. vs. *Edwards,* 267 U. S. 442;
Atlantic Coast Line Ry. vs. *Daughton,* 262 U. S. 413;
Underwood Typewriter Co. vs. *Chamberlain,* 254 U. S. 113;
Bass, Ratcliff and Gretton, Ltd. vs. *State Tax Commission,* 266 U. S. 271.

Since a state may include in the measure of a franchise tax net income not taxable directly, there can certainly be no doubt of its power to include net income which is taxable directly. Thus in the *Underwood Typewriter Co.* case this court said:

> "A tax is not obnoxious to the commerce clause merely because imposed upon property used in interstate commerce, even if it takes the form of a tax for the privilege of exercising its franchise within the State. *Postal Telegraph Cable Co.* v. *Adams,* 155 U. S. 688, 695. This tax is based upon the net profits earned within the State. That a tax measured by net profits is valid, although these profits may have been derived in part, or indeed mainly, from interstate commerce is settled. *U. S. Glue Co.* v.

Oak Creek, 247 U. S. 321; *Shaffer* v. *Carter,* 252 U. S. 37, 57; compare *Peck & Co.* v. *Lowe,* 247 U. S. 165. Whether it be deemed a property tax or a franchise tax, it is not obnoxious to the commerce clause." (254 U. S. 113, at 120.)

It is beyond question therefore that a tax measured by net income, attributable to business done in California even though derived in part from interstate or foreign commerce, imposes no burden upon interstate or foreign commerce.

As a matter of fact the state, in the case of domestic corporations such as appellants, could have imposed a tax upon, or measured its franchise tax by, the entire net income of the corporations.

Lawrence vs. *State Tax Commission,* 286 U. S. 276;

Cream of Wheat vs. *Grand Forks,* 253 U. S. 325;

Schwab vs. *Richardson,* 263 U. S. 88;

See also, *Kansas City, Memphis & Birmingham R. R. Co.* vs. *Stiles,* 242 U. S. 111.

Thus, the state not only did not burden interstate and foreign commerce but actually imposed a tax upon appellants more limited in extent than it could have imposed.

III

THE ACT DOES NOT DENY APPELLANTS THE EQUAL PROTECTION OF THE LAWS

Appellants contend that the tax constitutes a denial of equal protection of the laws by requiring of corporations engaged solely in intrastate commerce a tax measured by net income only from such commerce, whereas corporations engaged also in interstate and foreign commerce are required to pay a tax measured not only by the net income from intrastate commerce but also by the net income from interstate and foreign commerce attributable to business done within the state.

It must be observed, however, that the Act employs the same measure for all corporations taxable thereunder, i.e., net income, exclusive of net income attributable to business done outside the state. If a corporation engaged in intrastate commerce is not required to pay a tax measured in part by net income from interstate or foreign commerce, it is because it has no such net income and not because of any provision in the Act. Appellants' contention assumes that the measure is not uniform because of differences in the amounts of net income of the various corporations taxed.

As this court said in

La Belle Iron Works vs. *United States*, 256 U. S. 377, at 393:

"If in its application the tax in particular instances may seem to bear upon one corporation

more than another, *this is due to differences in their circumstance,* not to any uncertainty or want of generality in the tests applied."

See also

Barnsdall Oil Company vs. *Merriam,* 8 Fed. Supp. 185, 187.

If appellants' contention were sound it is a denial of equal protection of the laws to include any net income in the measure of the tax on corporations having net income as long as there are corporations without net income. Similarly, corporations would be denied equal protection of the laws because other corporations with less net income paid lower taxes. Such a rule would invalidate all taxation.

Appellants' contention is manifestly unsound in view of *Underwood Typewriter Co.* vs. *Chamberlain,* 354 U. S. 113, and *Bass, Ratcliff & Gretton, Ltd.* vs. *State Tax Commission,* 266 U. S. 271, since net income from interstate commerce was included in the measure of the taxes there involved, regardless of the fact that other corporations doing solely intrastate business did not pay a tax on or measured by any such net income.

Appellants argue (App. Brief, p. 53) that since a foreign corporation engaged exclusively in interstate commerce between this state and other states is not subject to the act whereas another foreign corporation doing precisely the same character and amount of interstate business is subject to the act if it does some intrastate business, the act arbi-

trarily discriminates between such corporations and the act therefore is void. In support of this contention appellants cite *Royster Guano Co.* vs. *Virginia,* 253 U. S. 412.

The *Royster Guano Company* case does not support appellants' contention. The corporations which were exempted from the tax therein involved, and the exemption of which was held to render discriminatory the tax on the corporations not exempted, could have been subjected to the tax to the same extent as the corporations taxed (see opinion of the court, p. 416) but were *voluntarily and deliberately* exempted from the tax by the statute. The situation in the instant case is different.

As clearly pointed out by the State Supreme Court in its opinion in the instant case, the exemption of corporations engaged exclusively in interstate commerce resulted solely from the fact that it is beyond the power of the state under the Federal Constitution to impose a franchise tax on such corporations. The fact that the Constitution of the United States exempts certain corporations from the tax does not prevent the application of the tax to corporations not so exempt. This proposition is unqualifiedly supported by the decision of this court in *Des Moines Bank* vs. *Fairweather,* 263 U. S. 103, sustaining a state tax on national bank shares although no deduction was allowed for the banks' investment in tax exempt securities whereas

private bankers were allowed such a deduction. In the course of its opinion this court stated:

> "Our concern here is not with a voluntary refusal or intentional omission on the part of the State to tax other moneyed capital of citizens as it taxes national bank shares, but with a submission by the State to superior laws of the United States exempting a part of the other moneyed capital from state taxation. It may be helpful to state the matter in another way. National bank shares are taxable,—made so by the congressional assent. That much or little of the bank's assets consists of tax-exempt securities of the United States does not affect the taxability of the shares,—they being distinct from the corporate assets. The State taxes such shares without regard to the exempt government securities held by the bank. The capital of private bankers is taxable, save the part invested in exempt government securities. The State taxes all of that capital, save the exempt securities. They are exempt because the United States makes them so, and the State merely respects the exemption."

Under appellants' contention, the measure of the tax could include only income from the strictly intrastate business of the corporations taxed. Thus, the same reasons that would require the exclusion of income from interstate commerce would require the exclusion of interest, rent, dividends, gains from the sale of property not made in the course of business, royalties, and numerous other types of income received by corporations not derived from their

intrastate business. (See section 6 of the Act.) The Act, however, has been held valid, notwithstanding that it requires the inclusion in its measure of net income not derived from the intrastate business, i.e., income from tax exempt securities.

Pacific Company vs. *Johnson,* 285 U. S. 480.

Clearly, if income from tax exempt securities can be included in the measure of the tax on corporations having such income, without denying them equal protection of the laws, other types of net income similarly not derived from intrastate business, including net income from interstate or foreign commerce, can be included in the measure of the tax on corporations having such net income without denying them equal protection of the laws.

IV

THE ACT DOES NOT DEPRIVE APPELLANTS OF PROPERTY WITHOUT DUE PROCESS OF LAW

The foregoing discussion, with respect to equal protection of the laws, disposes also of appellants' contention that the tax in question deprives them of property without due process of law. In addition, it may be observed that the jurisdiction of the state to impose a tax upon domestic corporations for the privilege of exercising their corporate franchises within its limits even though the corporations are

also engaged in interstate or foreign commerce is no longer open to question.

Detroit International Bridge Co. vs. *Tax Appeal Board of Mich.*, 287 U. S. 295;
Pacific Company vs. *Johnson*, 285 U. S. 480;
Western Cartridge Co. vs. *Emmerson*, 281 U. S. 511;
New York vs. *Latrobe*, 279 U. S. 421;
Hump Hairpin Co. vs. *Emmerson*, 258 U. S. 290,
and other cases too numerous to mention.

No question of double taxation or of taxing income beyond the jurisdiction of the state can arise as the measure of the tax excludes income from sources outside the state. As a matter of fact, if appellants' position is sustained there will be added to the great bulk of their net income which escapes all state or territorial taxation the amount of income in question here clearly attributable to business done within the state. See *Southern Pacific Company* vs. *Kentucky*, 222 U. S. 63.

The case of *Hans Rees' Sons, Inc.* vs. *North Carolina*, 283 U. S. 123, cited by appellants has no bearing here. That case involved the question of taxing the net income of a *foreign* corporation from business done *outside* the state. The present case involves a franchise tax on *domestic* corporations measured by net income attributable to business done *within* the state.

CONCLUSION

Appellants, as domestic corporations deriving their existence and corporate franchises from the State of California, could have been required to contribute to the support of government therein according to the entire fruits and benefits of such franchises, i.e., their entire net income including net income from interstate or foreign commerce. The state, however, not only limited the measure of the tax to net income from sources and business within the state but made that tax in lieu of a property tax upon the full value of their corporate franchises. There can thus be no just cause to complain of the reasonableness of the tax. Appellants' attack upon the Act must, therefore, be confined to questions of form. The Act, however, in this respect is invulnerable. The subject of the tax is undoubtedly within the state's jurisdiction and the propriety of the measure is beyond question.

Respectfully submitted.

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